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New Zealand Milk and Dairy Products 2010 Seasonal Update

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Report Highlights:

New Zealand's total milk production in MY 2010 isn't likely to reach initial forecasts but, at 16.7 million tons of milk, will still surpass the MY 2009 total. Exports are forecast to be up slightly on initial forecasts.

EXECUTIVE SUMMARY

Post has revised the MY 2010 milk production forecast downward from the initial estimate of 17 million to 16.7 million tons, a decline of 1.7%. An El Nino weather pattern that brought drought conditions to the North Island is the primary reason for the forecast decline in production. However, total production is still forecast to be up almost 1% compared to last year because production gains on the South Island made up for losses on the North Island.

In line with the strength in global dairy prices, Fonterra, New Zealand's largest cooperative collecting an estimated 91% of total domestic milk supply, increased its raw milk payout forecast by 40 cents to NZ \$6.10 per kilogram of milk solids. This is the second increase this season. In November 2009, Fonterra increased the forecast payout to NZ \$5.70, up from the initial forecast of NZ \$4.60. At NZ \$6.10, this is the second highest payout on record after the NZ \$7.59 paid out during the 2007/08 season.

While the payout is clearly good news for New Zealand farmers, there are on-going concerns about the profitability of dairy farming. High debt levels, particularly for those who have expanded their operations recently, high input costs, and new costs associated with the implementation of New Zealand's Emissions Trading Scheme (ETS) are all negatively impacting on profitability. Looking forward, a widely held view among analysts in New Zealand is that domestic milk production will continue to grow between two and three percent per year over the near to medium term.

Post has revised the MY 2010 forecast upward slightly from 1.832 million tons to 1.84 million tons. While milk production forecasts have been adjusted downward due to the drought, a draw down in inventory levels will sustain export levels. WMP exports are forecast at 809,000 tons, just 1,000 tons below the previous estimate. Reflecting the current demand situation which favors SMP/AMF production, it is likely SMP exports will reach 390,000 tons in MY 2010, 66,000 tons up on the initial forecast, and butter/AMF exports will reach 415,000 tons, up on the previous forecast by 10,000 tons. Cheese exports, on the other hand, are now forecast at 292,000 tons, as compared to the original forecast of 225,000 tons.

Over the last twelve months, there have been significant increases in prices for products sold through Fonterra's Global Dairy Trade auction. During the twelve months to May 2010, WMP prices increased by 83% reaching US \$3,932. Other commodities (SMP, AMF) traded on this forum experienced similar gains. These gains are partly attributable to strong demand from China. On a value basis, China surpassed the United States in CY 2009 as the leading market for New Zealand dairy products. While exports to the U.S. market fell 25%, exports to China surged 76% reaching a record US \$646 million. China now accounts for nearly 12% of New Zealand dairy exports as compared to 9%

for the United States. Approximately 24% of New Zealand's total WMP exports are destined for China.

In September 2008, New Zealand implemented the "Emissions Trading Scheme" (ETS) an "all-sectors, all-greenhouse-gases" policy initiative. To date, only the forestry sector has entered the scheme but the transport, energy, fishing and industrial sectors are slated to join on July 1, 2010. Agriculture is expected to be phased into the scheme in 2015. Once phased in, the agriculture sector will receive an initial free allocation of 90% of its liability, which will be reduced over time. Estimates put the immediate costs of complying with the ETS at NZ \$10,200 for the average dairy farmer.

On April 7, 2010, Fonterra announced the third phase of its capital restructuring proposal, which includes the creation of a share trading system for its farmer shareholders. The general expectation is that an updated proposal will go through another round of farmer consultations and be put to a vote sometime in the second half of the year.

PRODUCTION

Milk Production

Post has revised the MY 2010 milk production forecast downward from the initial estimate of 17 to 16.7 million tons, a decline of 1.7%. An El Nino weather pattern that brought drought conditions to the North Island is the primary reason for the forecast decline in production. However, total production is still forecast to be up almost 1% compared to last year because production gains on the South Island made up for losses on the North Island.

- The New Zealand Government declared Northland in drought in January and, by April, declared four other regions – Waikato, Rodney, Papakura and Manukau – as drought zones;
- In April, production in the Waikato region, which typically accounts for over 30% of total milk production, was running as much as 25% behind last year on a day-today basis;
- By contrast, the South Island fared better with a cool and wet summer, and during the month of April, production in Southland was reportedly running 6% ahead of last year on a day-to-day basis.

The South Island, which accounted for an estimated 36% of total milk supply in MY 2009, up from 30% in MY2005, is expected to account for an expanding percentage of total domestic milk supply over time. One of the reasons for this is the sheer amount of land available for conversions away from sheep and beef to dairy production. According to one estimate, Southland, the southernmost province on the South Island, could potentially accommodate an additional one million cows.

During the 2008/09 season, South Island production was 355 kgs of milk solids per cow as compared to 314 kgs on the North Island. On a per hectare basis, South Island production was 1,018 kgs of milk solids compared to 892 kgs on the North Island.

It's worth noting that, if weather and other factors align for a good growing season, there is already enough capacity on the ground in New Zealand to boost milk supply by 10% above the level produced in MY 2009.

Farm-gate Prices and Profitability

In line with the strength in global dairy prices, Fonterra increased its raw milk payout forecast by 40 cents to NZ \$6.10 per kilogram of milk solids. This is the second time that Fonterra has increased the forecast payout this season. In November 2009, Fonterra increased the forecast payout to NZ \$5.70, up from the initial forecast of NZ \$4.60. At NZ \$6.10, this is the second highest payout on record after the NZ \$7.59 paid out during the 2007/08 season. Fonterra shareholders will also receive a dividend

payment forecast at between NZ \$0.20 to 0.30/kg of milk solids. Currently, Fonterra shareholders must pay a share price of NZ \$4.52 for each kg of milk solids supplied to the cooperative.

While the payout is clearly good news for New Zealand farmers, there are on-going concerns about the profitability of dairy farming. High debt levels, particularly for those who have expanded their operations recently, high input costs, and new costs associated with the implementation of New Zealand's Emissions Trading Scheme (ETS) are all negatively impacting on profitability. Based on a carbon tax of NZ \$25 per ton in 2015, the New Zealand Ministry of Agriculture (MAF) estimates the ETS will cost each dairy farmer NZ 2.5 cents per kilogram of milk solids.

New Zealand: Profitability of Dairy Farming (NZ dollars per kilogram of milk solids)					
Key Indicator	FY 06	FY 07	FY 08	FY 09 estimated	FY 10 estimated
Milk Sales	4.13	4.12	7.35	5.06	6.35
Livestock and Other Income	0.21	0.31	0.44	0.32	0.35
Change in Value of Livestock	0.24	0.16	0.15	0.06	0.03
Total Gross Income	4.58	4.59	7.94	5.44	6.73
Farm Working Expenses	3.54	3.63	4.90	4.62	4.20
Operating Profit	1.04	0.96	3.04	0.82	2.53
Debt Servicing	0.98	1.01	1.30	1.34	1.50
Rent	0.10	0.10	0.09	0.08	0.08
Net Profit	-0.04	-0.15	1.65	-0.60	0.95

Sources: Dairy NZ Economics Group

Notes: Farm working expenses include depreciation and wages of management to the owner either real or adjusted; Data has been collected from owner operated farms which comprise approximately 67% of all dairy farms in New Zealand.

Milk Production Trends

Since 1990, New Zealand milk production has grown at an average annual rate of 4.6%. Much of this growth came from an increase in cow numbers, up from 2.2 million head in 1990 to 4.4 million head in 2009. According to Dairy New Zealand, productivity gains over the last ten years (1998-2008) have been on the order of 0.5% per year. However, this is undoubtedly skewed downward as a result of the 2008 drought. The productivity assessment for the decade which finished a year prior i.e. 1997 to 2007 showed annual gains of 1.8% p.a.

Looking forward, a widely held view among analysts in New Zealand is that domestic milk production will continue to grow between two and three percent per year over the near to medium term.

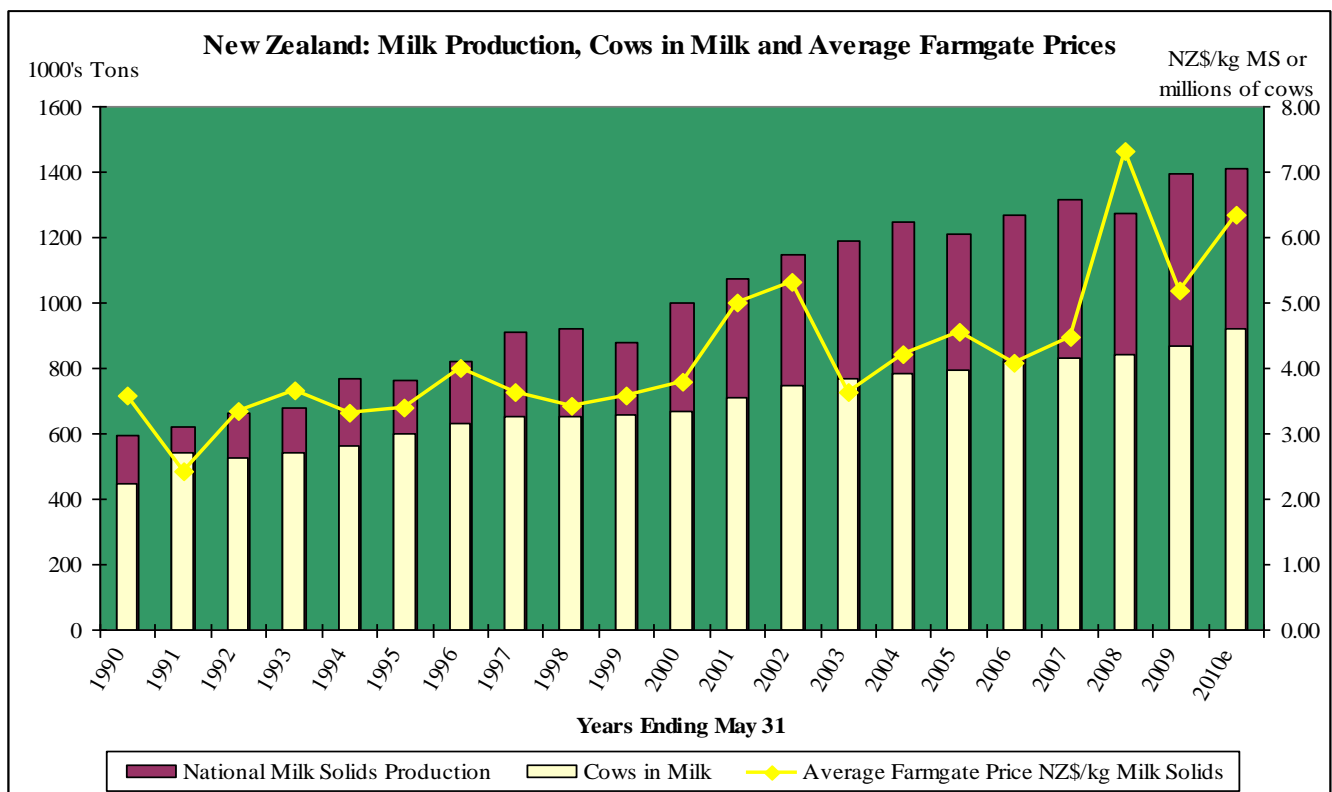
Factors that suggest sustained increased in production include:

- the relative profitability of dairying versus sheep/beef and/or crop production;
- strong global demand for dairy products, which, depending on supply levels and exchange rates, translates into high farm gate prices for New Zealand dairy farmers;
- the scope for enhanced productivity gains through genetics and other applied technologies; and,

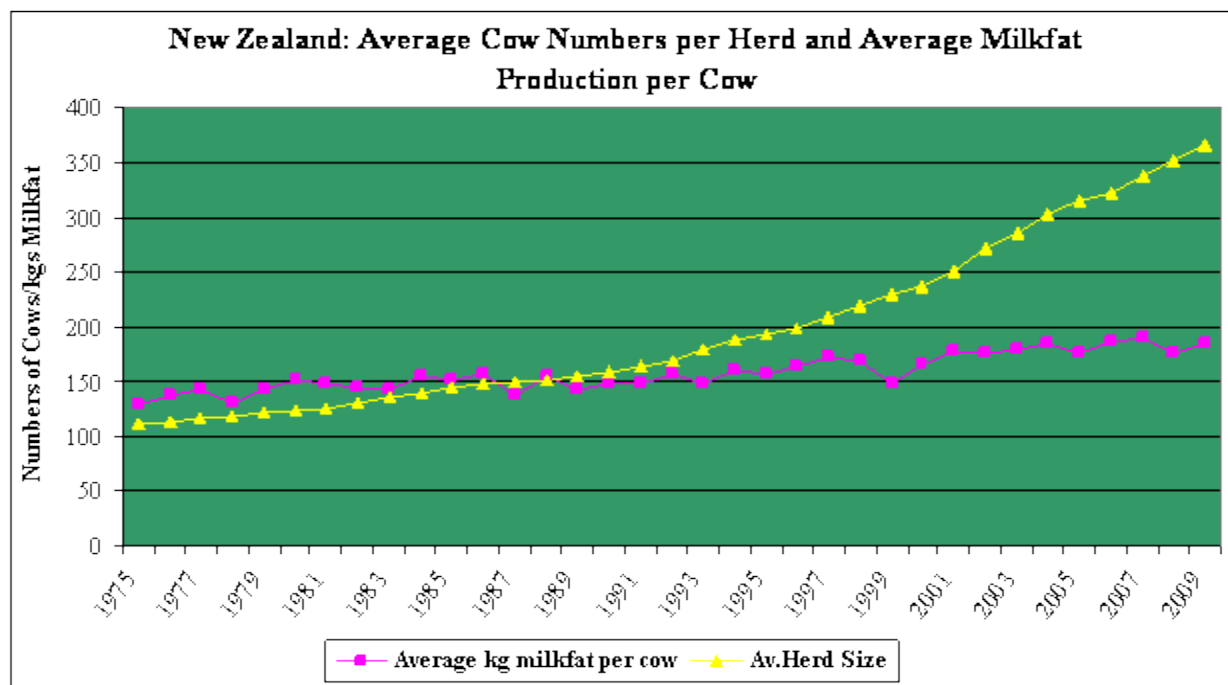
- the availability of suitable land for dairy production, especially in the lower part of the South Island.

Factors that could mediate the rate of increase in New Zealand milk production include:

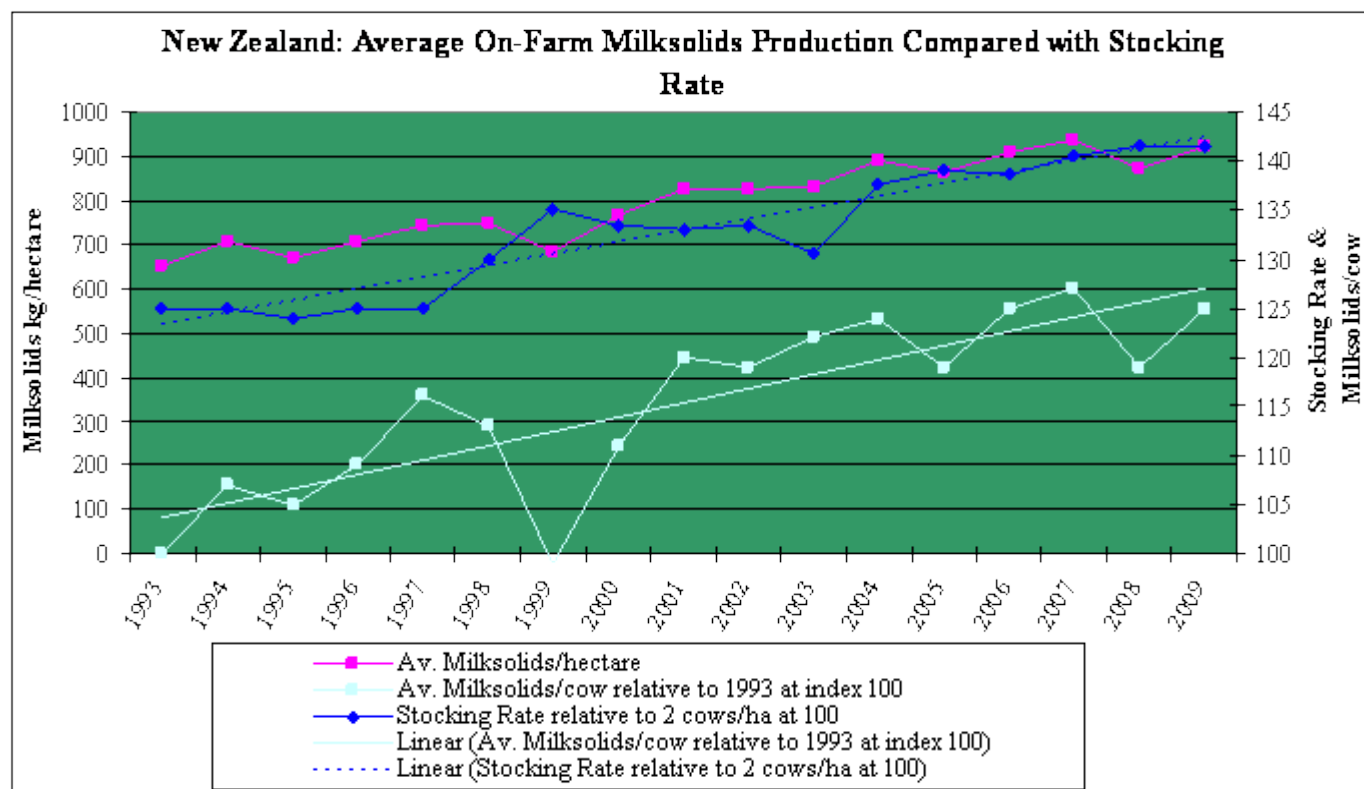
- relatively high land prices, especially relative to the cost of capital and the return on assets;
- relatively high debt ratios; (During the 2007/08 season, dairy farmers had debt to asset ratios of an estimated 35% and that figure is now estimated to have grown to between 40-45%, partly because land and share values have fallen.)
- increased costs associated with the implementation of the Emissions Trading Scheme (ETS), which will reduce on-farm profitability;
- increased compliance costs associated with addressing water quality issues (e.g. nitrates and pathogens associated with high effluent levels), which will negatively impact on-farm profitability; and,
- limited access to capital, which, along with other factors, has already slowed down the rate of conversions to dairy farming.



Source: Dairy NZ, MAF, and Post *Note: Estimate for 2010



Source: DairyNZ, LIC



Sources: LIC, Dairy NZ

Dairy Product Production

New Zealand Dairy Product Prices in US Dollars				
	March 2009	October 2009	March 2010	Percentage Increase
Butter	2,001	2,128	4,064	103%
Skim Milk Powder	2,043	2,057	2,994	47%
Whole Milk Powder	2,225	2,242	3,150	42%
Cheese	2,964	2,959	3,958	34%

Source: Global Trade Atlas

NZ US Dollar Exchange Rate			
March 2009	October 2009	March 2010	Percentage Change
0.5308	0.7383	0.7032	32.5%

Source: Reserve Bank of NZ

Whole Milk Powder

Post has reduced the estimate for MY 2010 whole milk powder (WMP) production downward by 50,000 tons to 750,000 tons. This puts WMP production down 4,000 tons compared to last year. The downward adjustment reflects comparative pricing levels as a product mix of Skim Milk Powder (SMP) and anhydrous milk fat production (AMF) has reportedly been more profitable to produce than WMP. Post has reduced the ending inventory estimate downward to 100,000 tons, down from the initial forecast of 150,000 tons. The downward revision is attributable to strong international demand and limited domestic supply availability.

Skim Milk Powder Production

In view of global price trends, post has adjusted the estimate for SMP production upward by 70,000 tons to 365,000 tons, which is 4,000 tons higher than last year's production level.

Cheese Production

Post has revised the estimate for cheese production downward by 56,000 tons to a total of 244,000 tons. Cheese inventories are forecast to remain stable at 55,000 tons.

In New Zealand, only one major new cheese plant has been built over the last ten years (Open Country Dairy in the Waikato). Given New Zealand's small population, most of the cheese produced is commodity-style cheese destined for export.

Butter and Fat Production

Post has adjusted the MY 2010 forecast for AMF production downward by 10,000 to 402,000 tons. While opening inventory levels are unchanged, post has reduced ending inventory levels by 20,000 tons to an estimated 40,000 tons. This is in line with industry expectations that all commodities will be sold and exported by the end of May 2010.

Consumer Ready Products

Only a small proportion (15-25%) of New Zealand's milk supply is processed into consumer ready products either in New Zealand or by one of the off-shore joint ventures or subsidiaries.

PSD TABLES

Dairy, Milk, Fluid New Zealand	2008			2009			2010		
	Market Year Begin: Jun 2007			Market Year Begin: Jun 2008			Market Year Begin: Jun 2009		
(1,000 Head/1,000 MT)	Offici al Data	Post Estima te	New Post Data	Offici al Data	Post Estima te	New Post Data	Offici al Data	Post Estima te	New Post Data
Cows In Milk	4200	4200	4200	4365	4365	4365	4470	4470	4470
Cows Milk Production	15141	15141	15141	16601	16601	16601	17021	17021	16726
Other Milk Production	0	0	0	0	0	0	0	0	0
Total Production	15141	15141	15141	16601	16601	16601	17021	17021	16726
Other Imports	0	0		2	2	2	2	2	2
Total Imports	0	0		2	2	2	2	2	2
Total Supply	15141	15141	15141	16603	16603	16603	17023	17023	16728
Other Exports	92	92	92	102	102	102	112	112	102
Total Exports	92	92	92	102	102	102	112	112	102
Fluid Use Dom. Consum.	345	345	345	331	331	331	340	340	340
Factory Use Consum.	14659	14659	14659	16125	16125	16125	16526	16526	16241
Feed Use Dom.consum.	45	45	45	45	45	45	45	45	45
Total Dom. Consumption	15049	15049	15049	16501	16501	16501	16911	16911	16626
Total Distribution	15141	15141	15141	16603	16603	16603	17023	17023	16728
CY Imp. from U.S.	0	0	0	0	0	0	0	0	0
CY. Exp. to U.S.	0	0	0	0	0	0	0	0	0
TS=TD			0		0	0	0	0	0

Dairy, Dry Whole Milk Powder New Zealand (1,000 MT)	2008			2009			2010		
	Market Year Begin: Jun 2007			Market Year Begin: Jun 2008			Market Year Begin: Jun 2009		
	Official Data	Post Estimate	New Post Data	Official Data	Post Estimate	New Post Data	Official Data	Post Estimate	New Post Data
Beginning Stocks	40	40	40	70	70	70	74	160	160
Production	651	651	651	754	754	754	800	800	750
Other Imports	1	1	1	1	1	1	1	1	0
Total Imports	1	1	1	1	1	1	1	1	0
Total Supply	692	692	692	825	825	825	875	961	910
Other Exports	621	621	621	750	664	664	810	810	809
Total Exports	621	621	621	750	664	664	810	810	809
Human Dom. Cons.	1	1	1	1	1	1	1	1	1
Other Use, Losses	0	0		0	0	0	0	0	0
Total Dom. Cons.	1	1	1	1	1	1	1	1	1
Total Use	622	622	622	751	665	665	811	811	810
Ending Stocks	70	70	70	74	160	160	64	150	100
Total Distribution	692	692	692	825	825	825	875	961	910
CY Imp. from U.S.	0	0	0	0	0	0	0	0	0
CY. Exp. to U.S.	1	1	1	2	2	2	1	1	2
TS=TD		0	0		0	0		0	0

Dairy, Cheese New Zealand (1,000 MT)	2008			2009			2010		
	Market Year Begin: Jun 2007			Market Year Begin: Jun 2008			Market Year Begin: Jun 2009		
	Official Data	Post Estimate	New Post Data	Official Data	Post Estimate	New Post Data	Official Data	Post Estimate	New Post Data
Beginning Stocks	48	20	20	41	33	41	44	55	55
Production	292	314	320	294	345	300	306	300	244
Other Imports	6	6	6	4	6	4	6	6	5
Total Imports	6	6	6	4	6	4	6	6	5
Total Supply	346	340	346	339	384	345	356	361	304
Other Exports	283	283	283	275	325	270	292	292	225
Total Exports	283	283	283	275	325	270	292	292	225
Human Dom. Cons.	22	24	22	20	24	20	22	24	24
Other Use, Losses	0	0	0	0	0	0	0	0	0
Total Dom. Cons.	22	24	22	20	24	20	22	24	24
Total Use	305	307	305	295	349	290	314	316	249
Ending Stocks	41	33	41	44	35	55	42	45	55
Total Distribution	346	340	346	339	384	345	356	361	304

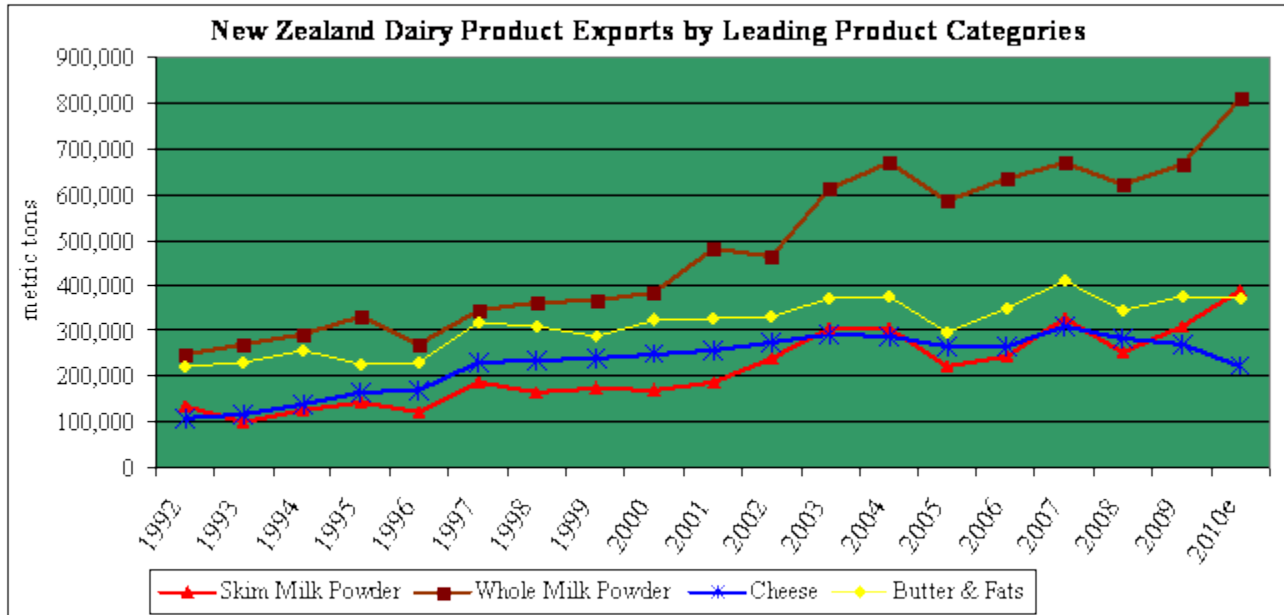
CY Imp. from U.S.	0	0		0	0	0	0	0	0
CY. Exp. to U.S.	19	19	19	28	23	28	25	25	2
TS=TD		0	0		0	0	0	0	0

Dairy, Milk, Nonfat Dry New Zealand	2008			2009			2010		
	Market Year Begin: Jun 2007			Market Year Begin: Jun 2008			Market Year Begin: Jun 2009		
(1,000 MT)	Official Data	Post Estimate	New Post Data	Official Data	Post Estimate	New Post Data	Official Data	Post Estimate	New Post Data
Beginning Stocks	29	20	20	34	34	34	70	85	70
Production	256	265	265	346	361	361	295	295	365
Other Imports	1	1	1	1	1	1	1	1	4
Total Imports	1	1	1	1	1	1	1	1	4
Total Supply	286	286	286	381	396	396	366	381	439
Other Exports	251	251	251	310	310	310	324	324	390
Total Exports	251	251	251	310	310	310	324	324	390
Human Dom. Cons.	1	1	1	1	1	1	2	1	4
Other Use, Losses	0	0	0	0	0	0	0	1	0
Total Dom. Cons.	1	1	1	1	1	1	2	2	4
Total Use	252	252	252	311	311	311	326	326	394
Ending Stocks	34	34	34	70	85	85	40	55	45
Total Distribution	286	286	286	381	396	396	366	381	439
CY Imp. from U.S.	0	0	0	0	0	0	0	0	0
CY. Exp. to U.S.	0	0	0	0	0	0	0	0	0
TS=TD			0		0	0		0	0

Dairy, Butter New Zealand	2008			2009			2010		
	Market Year Begin: Jun 2007			Market Year Begin: Jun 2008			Market Year Begin: Jun 2009		
(1,000 MT)	Official Data	Post Estimate	New Post Data	Official Data	Post Estimate	New Post Data	Official Data	Post Estimate	New Post Data
Beginning Stocks	38	40	38	70	43	70	75	75	75
Production	422	420	422	428	405	428	412	412	402
Other Imports	2	2	2	4	2	4	2	2	1
Total Imports	2	2	2	4	2	4	2	2	1
Total Supply	462	462	462	502	450	502	489	489	478
Other Exports	369	369	369	407	382	407	406	406	415
Total Exports	369	369	369	407	382	407	406	406	415
Domestic Cons.	23	23	23	20	23	20	23	23	23
Total Use	392	392	392	427	405	427	429	429	438
Ending Stocks	70	70	70	75	45	75	60	60	40
Total Distribution	462	462	462	502	450	502	489	489	478
CY Imp. from U.S.	0	0	0	0	1	0	0	0	0
CY. Exp. to U.S.	22	22	22	30	25	30	27	27	40
TS=TD	0	0	0	0	0	0	0	0	0

Note: Data included in this report is not official USDA data. Official data can be found at <http://www.fas.usda.gov/psd>

TRADE



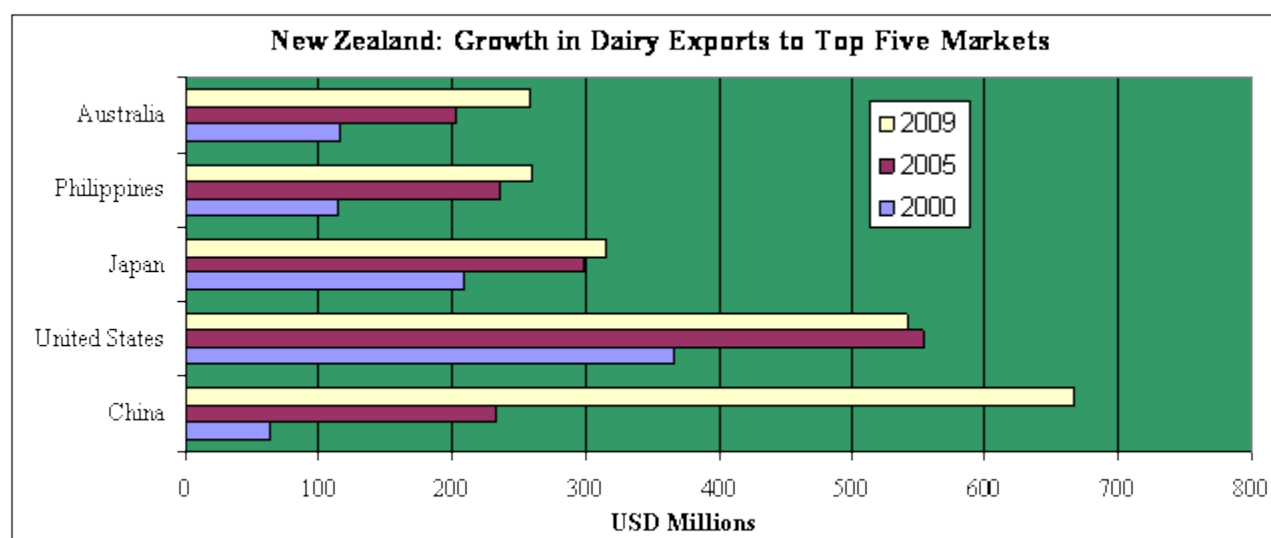
Source: GTA and Post Estimates

Post has revised the MY 2010 export forecast upward slightly from 1.832 million tons to 1.84 million tons. While milk production forecasts have fallen due to the drought, a draw down in inventory levels has sustained export levels.

- WMP exports, the backbone of the New Zealand dairy industry accounting for just on 44% of total PSD commodity exports, are forecast to remain relatively stable at 809,000 tons, just 1,000 tons less than the original forecast.
- Reflecting global supply and demand conditions, SMP exports are running well ahead of last year's export levels and are forecast to reach 390,000 tons in MY 2010, up 66,000 tons on the original forecast.
- While global cheese prices are up, cheese tends not to be as profitable a product to produce in New Zealand as compared to other products. Given current pricing trends for powders and AMF, post has reduced the original forecast for MY 2010 cheese exports downward from 292,000 tons to 225,000 tons,.
- Post has adjusted the export forecast for butter/AMF upward by 9,000 tons to 415,000 tons. Although post has revised the MY 2010 production forecast downward by 10,000 tons, a draw down in inventory levels will sustain the forecast increase in butter/AMF exports.

New Zealand exports dairy products to over 150 countries. On a value basis, the top five markets – China, the United States, Japan, the Philippines and Australia - account for approximately 35% of total exports.

New Zealand has free trade agreements with nineteen countries. Taken together, these countries, including the Gulf Cooperation Council, accounted for 44% of total New Zealand dairy exports (on a value basis) in CY 2009. Those same countries accounted for 39% in CY 2004. With the exception of Australia and Chile, most of the countries with which New Zealand has free trade agreements are in Asia and the Middle East and, many have limited domestic milk production.



Source: GTA

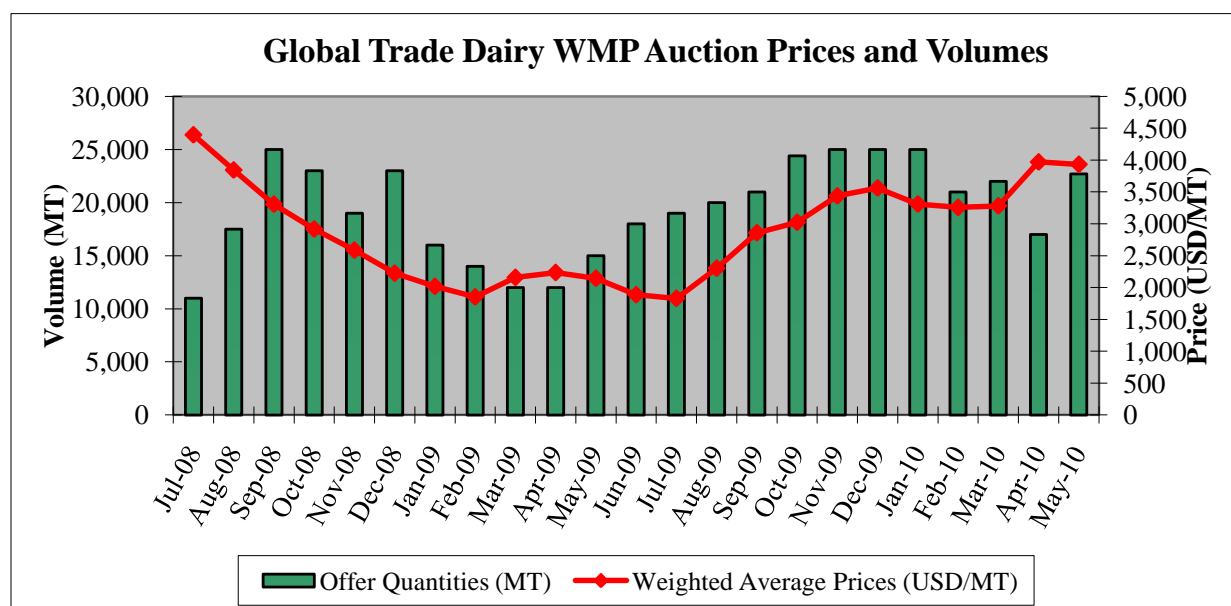
New Zealand: Dairy Product Exports to Top Five Markets by Type of Product (CY 2009/Metric Tons)					
	China	USA	Japan	The Philippines	Australia
Liquid Milk	5,585	582	1,584	31,537	4,470
Skim Milk Powder	50,199	178	7,686	42,208	5,935
Whole Milk Powder	171,491	3,233	15	20,692	7,615
Consumer Products	3,874	81	3,777	14,509	3,384
Milk Protein Concentrate	1,715	41,850	2,407	443	1,249
Butter and Fats	26,720	31,496	136	12,584	16,490
Cheese	9,222	17,465	46,325	11,446	52,349
Casein	3,199	32,022	9,965	1,593	1,209
Whey Products	8,889	6,674	4,852	462	2,352
Other Products (incl. lactose)	4,103	99	3,489	1	4,420
Total Volume	284,997	133,680	80,236	135,475	99,473
Total Value in USD	\$667,100,797	\$541,790,684	\$315,095,640	\$260,750,577	\$259,414,036
Price per Metric Ton in USD	\$2,341	\$4,053	\$3,927	\$1,925	\$2,608

Source: Global Trade Atlas

Key Developments during CY 2009

- On a value basis, China surpassed the United States in CY 2009 as the leading market for New Zealand dairy products. While exports to the U.S. market fell 25%, exports to China surged 76% reaching a record US \$646 million. China now accounts for nearly 12% of New Zealand dairy exports as compared to 9% for the United States.
- New Zealand's whole milk powder exports to China reached 151,611 tons during the first nine months of MY 2010, which is nearly 95,000 tons more than the second largest WMP export destination of Venezuela. At current rates, China is taking 24% of New Zealand's total WMP exports.
- New Zealand cheese exports to the U.S. market are expected to only reach 2,000 tons in MY 2010, down from a high of 37,000 in CY 2004. The low export level primarily reflects the low prices for cheese in the U.S. market.

Global Dairy Trade – The Fonterra Auction



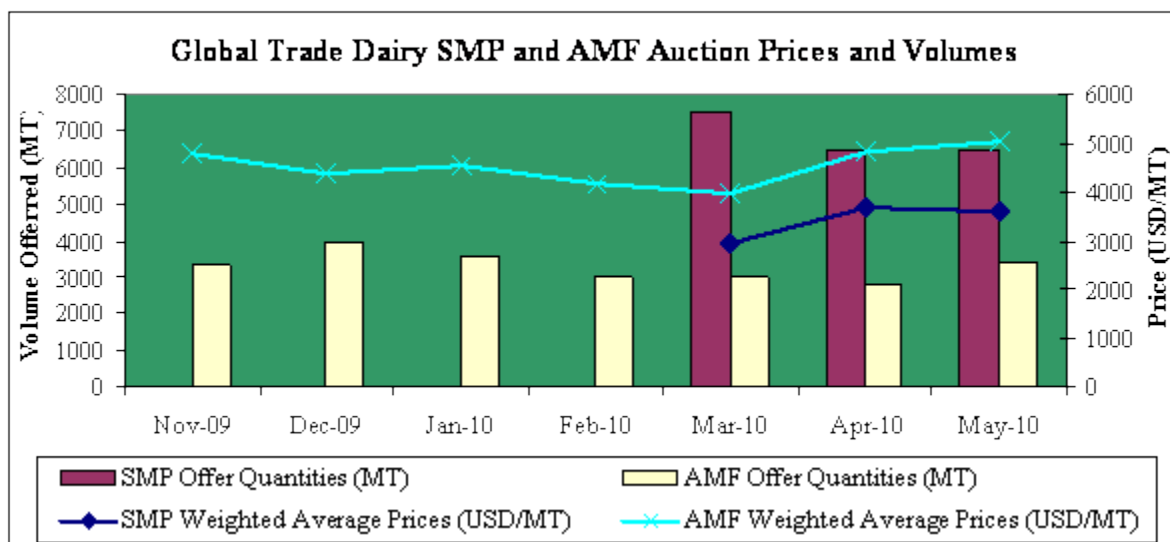
Source GDT

The tight supply situation in Oceania, coupled with a reduced volume put up for sale, resulted in a 21% spike in the weighted average price at the April auction.

Fonterra added AMF to the auction platform in November 2009 and SMP in March 2010.

Fonterra is forecasting in May 2010 that 480,000 tons of dairy products (WMP, SMP and AMF) will be sold through the auction in MY 2011, up from 303,700 tons in MY 2010 (187,500 tons in MY2009). In MY 2010, approximately 32% of WMP exported is estimated to be sold through the

auction. In MY 2011, the percentage sold through the auction is expected to reach between 35 and 37%.



Source GDT

New Zealand: Overview of Dairy Processors (other than Fonterra)						
Company Name	Date Established	Company Type	Estimated Total Milk Processed 2009/10 Season 1/	Estimated Milk Accessed under DIRA 2009/10 Season	Estimated Milk Processed 2012/13 Season	Product Focus
			(Millions of kilograms of milk solids)			
North Island						
NZ Organic Dairy Farmers Coop 1/	2008	Cooperative	2	0	0	Cheese
Tatua	1919	Cooperative	16.5	4.2	18	Caseinates, AMF, Specialty Products
Goodman Fielder		Corporate	20	20	20	Yogurt and Fluid Milk
Open Country Dairy	2007	Corporate	50	4.2	65	Cheese, Whey, WMP, SMP, AMF
Arapuni Milk Coy	Planning Capital Raising	Corporate	0	0	17	WMP
Sub-Total			88.5	28.4	120	
South Island						
Westland Milk Products	1937	Cooperative	46	0	50	Milk Powder, Butter, AMF, Caseins, Caseinates etc.
Open Country Dairy	2007	Corporate	25	0	25	Whey (low protein), WMP, SMP, AMF
NZ Dairies	2007	Corporate	18	3	18	WMP and Child Nutrition Products
Synlait	2008	Corporate	26	4.2	43	WMP, AMF, SMP and Nutritional Products

Mataura Valley Milk	In process of raising capital	Corporate	0	0	17	WMP
Oceania Milk	In process of raising capital	Corporate	0	0	17	WMP
Sub-Total			115	7.2	170	
Total			203.5	35.6	290	

1/ This company is in receivership.

Source: Agricultural Affairs Office Estimates

POLICY

Free Trade Agreements

While a strong supporter of the WTO, New Zealand has negotiated several bilateral and regional free trade agreements (FTAs) and is working on several more including agreements with Korea, India and Mexico, as well as the TransPacific Partnership (TPP) Agreement, which includes the United States. The first round of TPP negotiations took place in March in Australia, and the next round is scheduled to take place June 14-18 in the United States.

The most recent agreement signed by New Zealand is the Closer Economic Partnership (CEP) with Hong Kong, which was signed in March 2010. Although yet to be signed, New Zealand completed negotiations for an agreement with the Gulf Cooperation Council in November 2009. In October of 2009, New Zealand signed an FTA with Malaysia. In February 2009, New Zealand and Australia jointed signed at FTA with ASEAN. The FTA will eventually eliminate tariffs on 99% of New Zealand's current exports to the four key ASEAN markets of Indonesia, Malaysia, the Philippines and Vietnam. New Zealand signed an FTA with China in 2008.

In addition to the agreements noted above, New Zealand has three other FTAs in force - The Closer Economic Relations Agreement with Australia (1983), an agreement with Thailand (2005), and the Trans-Pacific Strategic Economic Partnership Agreement (TransPac) with Singapore, Chile and Brunei (2005).

For more information go to: <http://www.mfat.govt.nz/Trade-and-Economic-Relations/Trade-Agreements/index.php>

Emissions Trading Scheme

Reducing greenhouse gas emissions and meeting the country's obligations under the Kyoto Protocol is a high priority for the government. In September 2008, New Zealand implemented the Emissions Trading Scheme (ETS), an "all-sectors, all-greenhouse-gases" policy initiative. The ETS uses New Zealand's Kyoto allocation as the basis for determining the number of units in the market, but New Zealand participants have the option of sourcing additional units from offshore. To date, only the forestry sector has entered the scheme. The transport, energy, fishing, and industrial sectors are slated to enter the scheme on July 1, 2010. During the two-year transition period, participants will only be obliged to surrender one NZ unit for every two tons of CO₂ actually emitted and will be able to purchase units at a fixed price of NZ \$25 per ton.

The ETS has not been without controversy. Initially passed by the former Labour-led Government, the National Party pushed through amendments to the legislation in November 2009. Among other things,

the National Party delayed agriculture's entry into the scheme from 2013 to 2015. Once phased into the scheme, the agriculture sector will receive an initial free allocation of 90% of its liability, which will be phased out at 1.3% per year.

According to analysts, Fonterra and other dairy processors will have to pay an estimated NZ \$40 million in an "ETS tax" beginning this year, which will be passed on to dairy producers. At the end of the two-year transition period, the tax bill will double to an estimated NZ \$80 million. This does not include charges associated with animal methane and nitrous oxide, which make up less than a quarter of the total cost for the average New Zealand dairy farmer. Estimates put the initial cost of complying with the ETS at NZ \$10,200 for the average dairy farmer.

Quota Markets

Under the Dairy Industry Restructuring Act (DIRA), MAF has gradually been reallocating access to quota markets and phasing out Fonterra's exclusive supply arrangements since 2008. Access is based on the share of milk collected from farmers. Under the export license allocation system, entities that collect at least 0.1% of national milk solids collected from farmers are eligible for a pro rata share of the quota export licenses being re-allocated in any one year. Fonterra's 91% share of domestic milk collection means that it will retain control of the bulk of the access to quota markets. In 2010, licenses for quota access to the EU (butter, cheddar cheese and cheese for processing), Dominican Republic (milk powder), Japan (prepared edible fat), and the United States (cheese) are being reallocated.

Fonterra Capital Restructure Proposal

On November 18, 2009, Fonterra's farmer shareholders approved the first two stages of a capital restructuring plan aimed at raising equity to achieve global expansion plans, and rid the cooperative of share redemption risk. Farmer shareholders voted to: allow farmers to hold shares equivalent to 120 percent of their milk production, a 20 percent increase; and, revalue shares to reflect their restricted trading status, which is expected to result in a 10 to 30 percent decline in share value.

On April 7, 2010, Fonterra announced the third phase of its proposal, which includes the creation of a share trading system for its farmer shareholders. This means that, if approved by shareholders, farmers would be required to trade shares among themselves when they want to join or exit the cooperative, or alter the amount of milk supplied, rather than relying on the cooperative to buy or sell shares. Under the proposal, Fonterra would be able to issue shares up to 120 percent of the volume of milk supplied to the cooperative. Of this amount, 20 percent would be non-redeemable "dry" shares devoid of voting rights. With the proposed overall cap of 20 percent, there is potential to add up to 1.1 billion dollars of dry share capital. Individual farmers would be able to purchase and hold shares up to twice the volume of milk supplied.

To facilitate transactions, Fonterra is proposing the creation of “volume providers.” Designated by Fonterra, the volume providers would buy and sell shares at a set fee operating much like a currency exchange window at the airport. While this would undoubtedly facilitate buying and selling, it is not clear that there would be adequate demand from farmers to purchase more shares, particularly in a down market.

To address the need for liquidity, the proposal calls for the creation of a shareholder fund that, for the first time, would enable non-farmer shareholders to invest in Fonterra. Through the shareholder fund, investors would be able to purchase the rights to the dividends and capital movement of the shares, but not the shares themselves. The actual shares, and the voting rights, would be retained by the farmer who puts the dividend and the capital component up for sale.

Fonterra representatives are currently conducting consultations with farmers. The proposal is supported by the Fonterra Shareholders Council and initial conversations indicate that there is fairly strong farmer support for the proposal in its current form despite misgivings from other quarters in the sector. The general expectation is that an updated proposal will go through another farmer consultation round in the middle of the year and be put to a vote sometime in the second half of the year.